

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the **Matter** of the Appeal of)
INDIA PAINT AND LACQUER COMPANY)

Appearances:

For Appellant: Harry Kahan, Certified Public Accountant
For Respondent: Harrison Harkins, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929 as amended) from the action of the Franchise Tax Commissioner in overruling the protest of India Paint & Lacquer Company, a corporation, to his proposed assessment of additional tax for the taxable year ended December 31, 1938, in the amount of \$220.00.

The proposed assessment resulted from the action of two of Appellant's officers in "donating" to it \$5,500 due them as back salary. The transaction is described as follows in the minutes of a special meeting of the board of directors, held on May 18, 1937:

"The Chairman stated that the amount due to himself and Mr. Orr in back salary amounted to \$5,572.42 on April 30, 1937. He also stated that in order to better the financial ~~state-~~ment of the corporation for credit purposes, Mr. Orr and himself were willing to donate to the corporation \$5,500 of the accumulated back salary. It was then resolved and unanimously carried that the said offer of donation be accepted by the corporation."

Since Appellant's accounts were kept on an accrual basis, the items comprising the above amount of \$5,500 were deducted by Appellant in computing its net income for the years 1936 and 1937, in accordance with Section 8(a) of the Act. The Respondent maintains that as a result of these circumstances, the taxable net income of Appellant for the year 1937 was increased in the amount of \$5,500 under the following provision of Section 8(o) of the Act:

"If a bank or corporation is allowed a deduction under this Section for an obligation and is subsequently discharged from liability ~~therefor~~ without having made

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"full payment thereof, the amount of such obligation shall constitute income to the bank or corporation for the year in which the liability is discharged."

The Appellant contends that because no consideration was given by it, the transaction of May 18, 1937, constituted a contribution to its capital, and under the decisions in Commissioner v. Auto Strop Safety Razor Co., 74 F.(2d) 226, and In the Matter of Triple Z Products, Inc.. Bankrupt, decided by the United States District Court for the Southern District of New York on September 9, 1940, and reported in 1940 Prentice Hall Federal Tax Service, Para. 62816, applying the Federal Revenue Acts, did not result in the realization of income; that Section 8(o) was not intended to apply in such cases, and that in any event, it can have no possible application in this matter because it did not become effective until August 27, 1937, several months after the transaction in question took place.

The Appellant does not deny, however, that in computing the measure of its tax, the salaries in question were deducted from gross income for the years in which they accrued, and that as a result its tax liability was correspondingly reduced, nor does it deny that the transaction of May 18, 1937, relieved it of its obligation to pay the \$5,500 of accumulated back salary. In our opinion, there is no escape from the conclusion that Appellant was "allowed a deduction under" Section 8 for the salaries due its officers and was "subsequently discharged from liability therefor without having made full payment," so that in accordance with the specific provisions of the Act, the amount of the discharged obligation must be included in its income. The Federal cases cited by Appellant did not involve statutory provisions similar to Section 8(o), and therefore have no relevancy in the determination of this appeal.

There is likewise no merit in the contention that Section 8(o) is inapplicable with respect to transactions occurring prior to its effective date. Section 19 of the Act which added Section 8(o) (Chapter 836, Statutes of 1937) specifically provides that "The provisions of this act effecting changes in the computation of taxes ... shall be applied only in the computation of taxes for taxable years commencing after December 31, 1937." Since we are concerned here with Appellant's tax for the year commencing January 1, 1938, and the tax is based upon its income for the year 1937, there is no question but that the computation of such income must be in accordance with the 1937 amendments. Any doubts that might otherwise exist concerning the constitutionality of applying the 1937 amendment in this fashion are foreclosed by Fullerton Oil Co. v. Johnson, 2 Cal. (2d) 162,

O R D E R

Pursuant to the views expressed in the opinion of the

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Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of India Paint & Lacquer Co. to a proposed assessment of an additional tax in the amount of \$220.00 for the taxable year ended December 31, 1938, based upon the income of said company for the year ended December 31, 1937, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

-Done at Sacramento, California, this 7th day of July, 1942, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
George R. Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary